



Interoffice Memorandum

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Guatemala Tax Issues

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Creditable Taxes

Subject to certain limitations, both the Guatemala corporate income tax and the Guatemala profits remittance tax (effectively a branch profits tax) are creditable taxes for U.S. income tax purposes. Any Guatemalan tax that is not creditable against U.S. income taxes will be deductible from U.S. taxable income.

The creditability of the Guatemalan stamp tax presents a difficult question because it has the attributes of both creditable and non-creditable taxes. In its application to profit distributions it resembles a withholding tax which would ordinarily be creditable. But, the stamp tax is imposed as a documentary tax on other transactions where there are no earnings. It is most likely that the stamp tax would not be treated as creditable.

Limitations on the Foreign Tax Credit

In order to realize a credit for Guatemalan income or remittance taxes, there must be a U.S. tax liability to credit the Guatemalan taxes against. It is possible to carry back excess foreign taxes three years and to carry them forward five years. Any transaction by PQPC that is deductible in the U.S. but not in Guatemala has the potential to reduce U.S. tax liability so that excess Guatemalan taxes accrue. In other words, such a transaction would produce no tax benefit or only a partial tax benefit that could be recorded in the earnings of PQPC. An example of this is discontinuing the B & H charge on fuel in favor of paying Sun King from the U.S. home office.

One of the requirements of the foreign tax credit is that the payment made to a foreign taxing authority is not a voluntary payment. A U.S. taxpayer is under a duty to minimize his foreign income tax liability when it is possible to do so. As Jorge has advised, it will be possible to establish additional Guatemalan tax basis for the plant without incurring stamp tax. Under these circumstances, failure to deduct the additional basis in Guatemala would result in the additional Guatemalan tax liability being non-creditable. A taxpayer may adopt a longer depreciation life for his foreign assets without making the tax payment voluntary because it does not increase his tax liability over time. Increased tax liability due to inability to pay Sun King in Guatemala does not run afoul of this concept either.

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Deductible Taxes

My understanding is that the Guatemalan income tax is deductible in Guatemala only for the purpose of determining the Guatemalan profit remittance tax. The remittance tax is not deductible in Guatemala. Most of the other Guatemalan taxes, including the stamp tax, are deductible there. Withholding taxes on payments to foreigners are deductible from Guatemalan taxable income when the Guatemalan payor bears the economic cost of the tax through a gross-up and the underlying payment is deductible.

Fuel Payments

The system of making dispatch payments to our Guatemalan O & M company ("EEG") and then EEG making a brokerage and handling payment for fuel delivered from other Enron affiliates was adopted in order to find a way to make the Sun King payment fully deductible in Guatemala and avoid having to gross-up the 25% Guatemalan withholding tax on such payments. The gross-up would convert the 6% payment to an 8% payment.

When an Enron company in the U.S. makes a payment to Sun King, our reporting position for not deducting U.S. withholding taxes is that Sun King earned the income outside the U.S. If the payment comes from an Enron affiliate that has no connection with the B & H payment, it may be difficult to establish that Sun King is being paid for services performed outside the U.S.

There are several problems with this method. First, Guatemalan tax authorities could disallow PQPC the deduction for the dispatch payment. Second, a 10% tax has been imposed on the import of fuel which is effectively a non-creditable tax on the B & H. Third, our business people have stated that the B & H is creating problems with PQPC's fuel sales activities. Finally, the dispatch payments have been smaller than anticipated, leaving EEG with a loss. EEG can carry its losses forward for only four years, making it possible that some of the Sun King payments will not produce any tax benefit in Guatemala or the U.S.

Continuing Payments to Sun King

The U.S. based alternative for continuing payments to Sun King is to end the dispatch and B & H payments. The additional cash flow for the branch would result in higher Guatemalan income and profits remittance taxes compared to what we are doing now. The cash would be paid from PQPC's home office to Sun King. This gives a deduction in the U.S., but not in Guatemala. It is likely to result no tax benefit or only a partial tax benefit for PQPC's

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earnings. Bill Leggatt has told me that to satisfy the IFC, the payments to Sun King would be subordinated to the debt.

Lump Sum Payment to Sun King

If the decision to buy out Sun King is adopted, the U.S. based alternative uses a new parent company owned by Enron and King Ranch. The new parent owns 100% of PQPC and files a consolidated U.S. income tax return with PQPC. This reorganization can be accomplished without adverse U.S. tax consequences. The new parent will borrow the funds for the buy out and will make the lump sum payment to Sun King. Its use is intended to satisfy IFC restrictions on additional borrowing by PQPC. The consolidated U.S. return allows any interest on the loan, or deductible amounts of the settlement, to be offset against PQPC's income from power sales. This plan may be affected by limits the IFC places on PQPC's ability to pay dividends. Based on work being done by Leesa White, there are two possible U.S. tax results. One outcome is that a lump sum buy out payment would be deductible from U.S. taxable income. The other is that the payment would have to be capitalized and amortized over the remaining life of the PPA. Leesa will be completing a memo on this issue in a few days. The buy out payment would not produce any Guatemalan tax deduction which making it likely that the transaction will not realize a full tax benefit for PQPC's earnings.

Bill Leggatt has requested that I wait to provide comments on the Guatemala based alternatives for dealing with Sun King until after our local advisors have completed their work on the issue.

Capitalization of PQPC

It has been determined that repatriation of cash can be accelerated if the PQPC branch has subordinated debt substituted for most of its equity. Because payments between the branch and its home office will be treated by Guatemala as dividends that are subject to withholding tax, our local advisors have told us to route the loan from the home office to the branch through a separate entity.

I recommend that a limited partnership be established under the Uniform Limited Partnership Act, as adopted by any State in the U.S. I leave the actual selection of jurisdiction to our legal department. PQPC will be the general partner. King Ranch and Enron may each have a 1% limited partnership interest. Under the limited partnership agreement the partnership will dissolve if any partner becomes bankrupt. The PQPC home office will contribute its receivable due from the branch to the partnership. A promissory note will be signed by the Branch in favor of the limited partnership. The limited partners will make a de minimis capital

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contribution. All of the interest income and distributions due to principal payments will be specially allocated to PQPC. The limited partnership will have no other business activities. This should produce an entity that appears separate for Guatemalan purposes (according to our local advisors), but can be disregarded for U.S. tax purposes. The partnership should not have Enron or Puerto Questale in its name. It must have the word "finance" in its name. Use the name "Caribbean Finance Limited Partnership" if no one objects.

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